



Investment Office

P.O. Box 2749

Sacramento, CA 95812-2749

Telecommunications Device for the Deaf - (916) 795-3240

(916) 795-3400

October 20, 2008

AGENDA ITEM 9b

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Corporate Governance - Corporate Board Diversity
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information
- IV. ANALYSIS:**

Executive Summary

Corporate directors and management should have a long-term strategic vision that, at its core, emphasizes sustained shareholder value creation as the global capital markets continue to evolve. CalPERS believes corporate board diversity is an important attribute in defining how each director fits within the skill sets necessary to be competitive in the evolving market place while focusing board and executive management attention on optimizing company operating performance and total stock return. In March 2008, California State Controller John Chiang asked CalPERS to consider a new initiative to address corporate board diversity. In April 2008, the Investment Committee directed staff to carry out the following three action items and report back in six months:

1. Address corporate board diversity with Focus List Program companies.
2. Engage proxy advisors on their board diversity policies with the objective of encouraging them to adopt a position consistent with CalPERS' position.
3. Develop a white paper on best practices for corporate boards to follow in seeking diversity on their boards, including how diversity is linked to performance.

Background

In a letter dated February 6, 2008 (Attachment 1), California State Controller John Chiang urged CalPERS to consider a new initiative that would proactively address the issue of diversity on the boards of corporations in which CalPERS invests. At its March 17, 2008 meeting, the Investment Committee considered Controller Chiang's letter and directed staff to come back with a range of options to elevate the importance of corporate board diversity through CalPERS' leadership in corporate governance practices. CalPERS agreed with Controller Chiang's perspective that diversity in the board room can inherently lead to greater creativity, more vigorous deliberation, and more integrity of processes, all of which are desirable traits and consistent with principles of good corporate governance.

CalPERS believes that a corporate board of directors should establish and disclose the mix of director attributes, experiences, diverse perspectives, and skill sets that are most appropriate for a company. This view derives from the observation that the global economy is becoming much more diverse and that successfully competing within the evolving economy requires adaptation and recognition of changing wealth and influence demographics. Consequently, on March 17, 2008, the Investment Policy Subcommittee amended the CalPERS Principles of Accountable Corporate Governance (Principles). The CalPERS Principle section III.B.2.4 now states the following:

"Director Nominations: With each director nomination recommendation, the board should consider the issue of continuing director tenure, as well as board diversity, and take steps as necessary to ensure that the board maintains openness to new ideas and a willingness to critically re-examine the status quo."

Staff reviewed CalPERS' corporate governance policies and Principles and it was evident that the Principles constituted the substance and core of all the "value" statements within the corporate governance program. This positioning of the Principles makes them the ideal location and framework for statements on board diversity and thus links diversity concepts to all of CalPERS' corporate governance activities.

At the April 21, 2008 Investment Committee meeting, staff presented three proactive options to address corporate board diversity within CalPERS' portfolio companies and the general marketplace. Consequently, the Committee directed staff to carry out three action items and report back with an update on each of the action items within six months.

Action Item 1 – Focus List Engagement

The 2009 Preliminary Focus List was approved by the Committee in Closed Session on September 15, 2008. Staff is currently scheduling initial meetings with board members and executive management of each Preliminary Focus List Company. These initial meetings are expected to take place through the end of 2008 and into early 2009.

Staff has amended its process for developing an agenda of topics to include corporate board diversity at each Focus List Company meeting. Discussions will center on how the board of directors establishes and discloses the mix of director attributes, experiences, diverse perspectives and skill sets that are most appropriate for optimizing operating performance and total shareowner return. At each meeting, staff will request each board to provide the steps taken to ensure that the board maintains openness to new ideas and a willingness to critically re-examine the status quo as it relates to director nominations, director tenure, as well as board diversity. Staff will emphasize the increasingly global nature of the marketplace and stress the importance of having a wide range of perspectives on the board to maintain a sustainable competitiveness.

Staff will report back to the Investment Committee on its progress in addressing corporate board diversity through the engagement of 2009 Preliminary Focus List Companies upon presentation of the final 2009 Focus List in March.

Action Item 2 – Proxy Advisor Engagement

Staff has engaged RiskMetrics Group, Egan-Jones Proxy Services, Glass-Lewis & Co., and Proxy Governance for the purpose of impressing upon each firm CalPERS' position on corporate board diversity and requesting leadership from each firm to support initiatives and proposals that enhance shareowner value creation through corporate board diversity.

On July 1, 2008, RiskMetrics Group opened its United States Institutional Policy Formation Process to gather input from institutional investors. This process helps RiskMetrics formulate policy guidelines for the 2009 proxy season. Although Risk Metrics did not have a specific policy on board diversity up for discussion in the survey, CalPERS did provide additional comment requesting further policy detail around board diversity. As other proxy advisors open their policies for discussion, staff is committed to continuing to stress the importance of this issue.

On September 9, 2008, staff engaged all four proxy advisors through written correspondence (Attachment 2) to emphasize the importance of diversity on corporate boards. In addition, the letter urges all the advisory firms to continue broadening their global policies to support initiatives that foster an environment of diverse perspectives and breadth of experiences at all companies.

Corporate Governance staff will continue to stay engaged with each of the four advisory firms. Staff has scheduled follow-up meetings with each of the four firms to take place through the end of December 2008 for the purpose of seeking a dedicated commitment to broaden policies and proxy recommendation support for corporate board diversity initiatives. The upcoming 2009 proxy season will also provide an opportunity to have continued dialogue with the four firms and influence their policies around corporate board diversity for the upcoming proxy season.

Action Item 3 – Best Practices White Paper Development

The Investment Committee directed staff to develop a white paper on best practices for corporations to follow in seeking diversity on their boards, including how diversity is linked to performance, and current baseline information on the composition of corporate boards and management. Over the past several months, staff engaged several vendors about creating the white paper. As background information, each vendor was provided a copy of the April 2008 agenda item which included the Controller's letter. All vendors were asked to provide total cost, estimated timeframe for completion, and a scope of approach for developing the white paper.

From the proposals submitted, staff selected Virtcom Consulting. Virtcom Consulting is a strategy management consultancy firm focused on solving complex global and local diversity challenges. Founded in 2000, the firm has offices in New York City and London. Virtcom has experience working with multi-national corporations focusing on "diversity profit generation" by driving cost savings and revenue growth linked to diversity initiatives. The firm offers an array of diversity business solutions in three major areas: Strategy Solutions, Training, and Thought Leadership.

The scope of Virtcom Consulting's approach will include providing current diversity data on board composition, implications on firm economic value tied to diversity, and the role of diversity in competitively positioning a company globally. Virtcom Consulting's project development outline is as follows:

1. Company Best Practice Information Gathering
 - Examine U.S. companies that are leaders in board diversity and their best practices
 - Examine companies that have addressed diversity through alternative solutions
2. International Best Practices Information Gathering
 - Review innovative board solutions that have been developed in other countries

3. Targeted Interviews

- Selectively conduct interviews with representatives from key organizations

4. Analysis and Report Development

- Synthesize all information gathered
- Develop the report in close collaboration with CalPERS

5. Report Presentation

- Formally present the findings of the survey research analysis to CalPERS

Virtcom Consulting estimates the time frame to complete the white paper is approximately eight weeks following which staff will deliver the final product to the Investment Committee. Upon completion of the white paper, staff will identify opportunities to enhance CalPERS' Global Principles of Accountable Corporate Governance by including the best practices identified in the white paper.

Since the white paper will also provide the current composition of corporate boards, this data can serve as a baseline to see if efforts to improve corporate board diversity best practices are evident in the marketplace. Staff plans to use the white paper as an engagement tool when communicating with portfolio companies by providing innovative and alternative solutions for implementing best practices. In addition, staff will identify opportunities to distribute and present the white paper to leading governance forums and institutions, industry groups, and diversity groups.

V. STRATEGIC PLAN:

This agenda item is consistent with the Strategic Plan: Goal IX, achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

The cost for developing the white paper is \$40,000 and is an incremental cost being funded through the Investment Office. The other items discussed are absorbed as normal operating expenses for the Corporate Governance unit. All efforts are viewed as advancing the organizations' diversity objectives and raising the awareness level of the topic.

Aeisha Mastagni
Investment Officer
Corporate Governance

Bill McGrew
Portfolio Manager
Corporate Governance

Mike Riffle
Portfolio Manager
Corporate Governance

Eric Baggesen
Senior Investment Officer
Global Equity

Anne Stausboll
Interim Chief Investment Officer